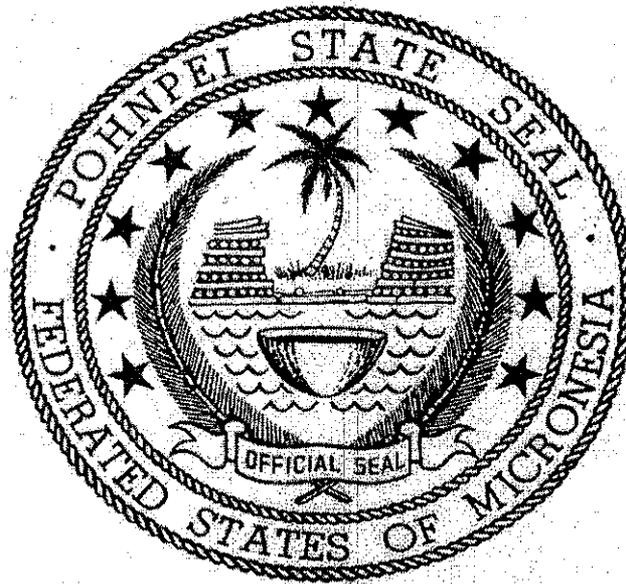


**COMPLIANCE AUDIT OF PROCUREMENT PRACTICES
OF DEPARTMENT OF HEALTH SERVICES
POHNPEI STATE**

AUDIT REPORT NO. 002-17

FISCAL YEARS 2014 and 2015



**POHNPEI STATE GOVERNMENT
OFFICE OF THE PUBLIC AUDITOR**

State Public Auditor
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**COMPLIANCE AUDIT OF PROCUREMENT PRACTICES
OF DEPARTMENT OF HEALTH SERVICES
FISCAL YEARS 2014 and 2015**

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October 10, 2017

The Honorable Marcelo K. Peterson, Governor, State of Pohnpei
The Honorable Fernando Scaliem, Speaker, Pohnpei State Legislature
The Honorable Members of the Pohnpei State Legislature
Mr. Kapilly Capelle, Director, Department of Health Services

EXECUTIVE SUMMARY

We are pleased to submit the Compliance Audit Report on Procurement Practices of the Department of Health Services, Pohnpei State for the fiscal years 2014 and 2015.

The audit was conducted in accordance with government auditing standards generally accepted in the United States of America contained in the *Government Auditing Standards* issued by the Comptroller General of the United States. Our audit was also conducted in compliance with the International Standards of Supreme Audit Institution (ISSAI) 4000. The audit was performed under the technical supervision of the Pacific Association of Supreme Audit Institutions (PASAI) and the Intosai Development Initiative (IDI). The audit was also performed pursuant to Article 11, Section 8 (2) of the Pohnpei State Constitution.

The main objective of our audit was to obtain sufficient and appropriate audit evidence to enable us to provide reasonable assurance on whether:

- Procurement contract planning, contract management, and review and completion activities were conducted, measured and evaluated in compliance with the FMR and with best practice as described in the Federal Acquisition Regulations (FAR) Part 7;
- Procurement information system were maintained, reviewed supervised, and reported in compliance with the FMR; and,
- Procurement financial and management controls; and financial activities were undertaken in compliance with the Fiscal Procedures Agreement, FMR and in compliance with established laws and regulations.

This is a compliance audit on the procurement contract practices of the Department of Health Services for the fiscal years 2014 and 2015. The annual budget of the Department for fiscal years 2014 and 2015 were \$6.7 M per year. 46% of the budget was used for the procurement of goods and services, while 54% was for personnel and travel expenses.

As a result of our audit, we conclude that:

1. The Department of Health Services (DHS) has not fully complied with the best practices in procurement regulations.
2. DHS has not fully complied with Pohnpei State financial management regulations requiring proper utilization of procured government assets. DHS needs to prioritize the procuring of the needed accessories to start using the X-ray machine. There is also a need to improve existing regulations to consider requiring the need assessment and pre planning on procurement of fixed assets.
3. The existing procurement system has not fully complied with best practice of ensuring that assets procured are properly accounted for.
4. DHS procurement contracts did not fully comply with procurement regulations. Management's failure to advertise or announce to the public by any means the need for vendors/contractors to bid on the specific projects heightens the risk of fraud and mismanagement of program funds.
5. The lack of documentation on the procurement transactions is non-compliance to procurement regulations.
6. The inadequate maintenance of an efficient inventory system does not fully comply with the best practice of properly accounting for the procurement of medicines and pharmaceutical supplies.
7. Management was not able to fully comply with the requirement of ensuring that procured assets are properly recorded in the inventory reports and reconciliation of property records between DHS and Supply Division was not also prepared.
8. Management was not able to ensure the maintenance of all the fixed assets procured during the year and to properly account for all fixed assets procured.

The summary of our recommendations are as follows:

2017-1 DHS does not follow procurement process that includes planning, preparation of the procurement processes and implementation of procurement.

We are recommending for the strengthening of the existing Financial Management Regulations and to prepare necessary guideline including regulations on procurement plans according to best practice which should be observed by the departments.

We are also recommending that DHS initiate the preparation of procurement plans identifying the procurement needs, properly consider approaches to procurement, preparation of procurement processes and implementation of procurement.

2017-2A Non-utilization of x-ray equipment purchased for immobile patients.

We are recommending management to conduct a needs assessment identifying assets or services to be procured. For assets to be procured, management should identify assets specification requirements to properly procure the item needed. We also recommend strengthening existing regulations to include needs assessment and pre planning to be undertaken before procuring fixed assets.

2017-2B Existing property accountability process has not fully complied with the Compact Fiscal Procedures Agreement in maintaining effective controls and accountability process.

We are recommending management to rectify and improve the existing property accountability process by considering the preparation of written records and memorandum receipts of fixed assets assigned to employees to ensure that assets procured are properly safeguarded and properly accounted for.

2017-3 Awarding of procurement contracts to vendors without following the bidding regulations.

Management should strictly comply with laws and regulations on procurement particularly the bidding regulations. In addition, management controls should be improved by implementing documentation review and supervisory review.

Pohnpei State Government procurement process should implement a documentation review at all stages from the DHS Contracting Officer, Legal Review, Budget Certification, Fund Certification and Director of Treasury review. A checklist of the documentation required in processing the procurement together with a complete set of supporting documents should be attached to the contract prior to approval signatures and processing of payments.

2017-4 Procurement related disbursements made without supporting documentations.

Management should strictly observe review of documentation before processing payments and ensure that records and files are retained for a minimum period of at least three years for records and reporting purposes. Supervision of staffs assigned to keep orderly and complete accounting records needs to be improved to strengthen controls and accountability.

2017-5A Non-maintenance of an inventory system for medicines and pharmaceutical supplies

Management should ensure that an efficient inventory system be made operational and working. Training of Pharmacy staffs assigned to use the computerized inventory system should be prioritized.

Management should improve monthly reporting requirements for procured medicines and pharmaceutical supplies to properly account for the procured items. Supervisory monitoring and review of work done by staff also needs to be improved.

2017-5B Non-maintenance of inventory records of procured assets and no reconciliation with State Supply and Property records.

Management needs to inform all Division Chiefs and key staffs of the regulations on fixed assets accountability and inventory reporting responsibility. There is also a need to provide guidance and train staffs in charge of inventory record keeping and reporting.

Management should ensure that fixed assets inventory are updated by recording procurement on a monthly basis and reconcile the fixed assets inventory with State Supply and Property records at least every two years to comply with the regulations.

The audit identified seven findings in the procurement practices in the Department of Health Services which are discussed in detail on pages 8 to 21 of the report. We also proposed our recommendations to each of the findings, which we believe if implemented would significantly improve DHS operations.

As is customary, we discussed the draft report with the management of Department of Health Services and requested for their responses to our findings. The response is included in the report as Exhibit I.

We also would like to inform management that as required by Pohnpei State Law No. 5L-08-00, the auditees are required to submit monthly report to OPA indicating corrective measures already taken, or will be shortly implemented to clear the deficiencies cited in the audit report until all findings are satisfactorily resolved, which period shall not exceed six months.

In closing, we would like to extend our sincere appreciation to Department of Health Services management and staffs for their support and assistance extended to us during the course of our audit.

With warm regards, I am.

Sincerely,


Iso Ihlen K. Joseph
State Auditor
Pohnpei

DEPARTMENT OF HEALTH SERVICES
Compliance Audit Report on Procurement Practices
Fiscal Years 2014 and 2015

INTRODUCTION

The Department of Health Services (DHS), also known as the Pohnpei State Hospital is one of the five departments of the Pohnpei State Government. The DHS was established under Article 7, Section 4 of the Pohnpei State Constitution. Its mission is to improve, promote, and protect the health status of the people of Pohnpei. In line with its mission, the DHS strategic goals are:

- 1) To improve the health status of the people by improving the medical services in the area of secondary health care (Curative Medicine). The department shall ensure that the basic secondary health care is accessible to all citizens.
- 2) To provide meal services, laboratory, X ray, pharmacy, ambulance, training, reception and fee collection services to support the medical services provided by the hospital.
- 3) To provide preventive dental care.

There are four divisions under the Department, namely:

- Division of Administration and Health Planning;
- Division of Medical Services/Hospital;
- Division of Primary Health Care; and the
- Division of Dental Health Services.

Each division is headed and administered by a Division Chief.

The annual budget of the department for FY 2014 and 2015 was \$6.7 M per year. 46% of this budget was used for the procurement of goods and services. The remaining 54% was used for personnel and travel expenses.

The Office of the Public Auditor (OPA) Pohnpei has considered conducting a Compliance Audit on the Procurement practices of DHS for the FY 2014 and 2015 as a result of an analysis of the risks as follow:

- Prior audits conducted on DHS revealed internal control weaknesses and deficiencies in its procurement activities;
- Contract planning, contract management and contract review and completion may not be conducted, measured and evaluated in compliance with the Pohnpei Financial Management Regulations (FMR) and best practice using guidelines of the Federal Acquisitions Regulations (FAR) Part 7 and the Compact Fiscal Procedures Agreement (CFPA), Article VI (j) (2 and 5);

- Procurement information system may not be maintained, reviewed, supervised and reported in compliance with the FMR and the Article VI 1. (f) (4) of the Compact Fiscal Procedures Agreement (CFPA); and,
- Procurement financial and management controls and financial activities may not be undertaken in compliance with the CFPA, the FMR (Part 3 and Part 6), which provide guidelines on the disbursements, contract payments and financial controls.

Pohnpei State is one of the four States comprising of the Federated States of Micronesia (FSM). The other three States are Chuuk, Yap and Kosrae. The FSM is an independent country in free association with the United States of America under a Compact of Free Association. Under the Compact, the United States Government, through its Department of the Interior (DOI), Office of Insular Affairs (OIA), is committed to providing economic assistance to the FSM. The maintenance of effective fiscal control and accountability process are specified in Article VI, Section 1(j) of the Compact Fiscal Procedures Agreement (FPA). The FPA sets forth procedures for the implementation of the United States Economic Assistance provided in the Compact of Free Association, as amended, between the United States Government and the Federated States of Micronesia Government. In addition, DHS is required and is expected to comply with the Pohnpei procurement and related laws, policies and procedures for all its purchasing transactions or activities.

AUDIT MANDATE

We conducted this Compliance Audit in accordance with the generally accepted government auditing standards contained in the *Government Auditing Standards* issued by the Comptroller General of the United States of America. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives. Our audit was also performed in compliance with the International Standards of Supreme Audit Institutions (ISSAI) 4000. This audit was conducted under the technical support and supervision of the Pacific Association of Supreme Audit Institution (PASAI), the INTOSAI Development Initiative (IDI) and pursuant to the provisions of Article 11, Section 8 (2) of the Pohnpei State Constitution.

AUDIT OBJECTIVES

The main objective of our audit was to obtain sufficient and appropriate audit evidence to enable us to provide reasonable assurance on whether:

- Procurement contract planning, procurement contract management, and procurement review and completion activities were conducted, measured and evaluated in compliance with the Financial Management Regulations (FMR) and with best practice as described in the Federal Acquisition Regulations (FAR) Part 7;

- Procurement information system were maintained, reviewed, supervised, and reported in compliance with the FMR; and,
- Procurement financial and management controls and financial activities were undertaken in compliance with the FPA, FMR and related procurement laws and regulations.

In order to achieve our objective, sufficient and appropriate audit evidence on compliance were obtained through controls and substantive procedures as indicated below:

1. Understanding the entity and evaluating internal controls;
2. Assessing whether DHS has properly maintained all records in accordance with the requirements of Pohnpei State Financial Management Regulations and related laws and regulations;
3. Assessing whether contract management has fully adhered to the FMR and in compliance with best practice as described in FAR part 7, and other applicable laws and regulations; and,
4. Assessing whether necessary internal controls were in place and financial activities were in compliance with Part 6 of the FMR and related applicable laws.

Subject matter:

The DHS procurement process is as follows:

- a) Each Division initiates the purchase transaction required following the government procurement guidelines provided in the FMR.
- b) All purchase transactions with amounts less than \$25,000 require price quotations from at least three (3) vendors.
- c) All purchase transactions valued at \$25,000 and above must be done through the bidding process.

Sole source purchasing may be considered in cases where the goods needed are available from one vendor only.

Open competitive bidding by sealed bids is also required for the following:

- a) Contracts for tangible property for which the estimated obligation of government funds is expected to be \$25,000 or greater, or such other amount as may be prescribed by law; and,
- b) Contracts for construction projects involving obligation of \$10,000 or more or such other amounts as may be prescribed by law.

Methodology:

In order to achieve our audit objectives, we conducted the audit according to the procedures generally described below:

- 1) Preliminary Contract Information
 - Identified the areas within the Department of Health Services where contract management was occurring;
 - Identified staffs responsible for contract management policy and procedures and conducted interviews of key staffs;
 - Interviewed staffs responsible for managing contracts;
 - Verified records and files and contract documents; and,
 - Performed other procedures necessary to achieve our audit objective.
- 2) Analyzed documents and prepared interview questionnaires for each key staffs. The auditors selected a combination of audit techniques to be able to form a conclusion with the selected level of assurance.
- 3) Gathered audit evidence using the following methods:
 - Observation
 - Inspection
 - Inquiry
 - External confirmation
 - Re-performance
 - Re-calculation
 - Substantive testing
 - Test of key controls
 - Analytical procedures

Prepared materiality testing and used audit sampling in testing procurement transactions.

The auditor used audit sampling, where appropriate, to provide a sufficient amount of items to draw conclusions about the population from which the sample is selected. In designing an audit sample, the auditor considered the purpose of the audit procedure and the characteristics of the population from which the sample was drawn.

- 4) Conducted review of prior audits or reviews undertaken to determine significant findings or non-compliance issues and other deficiencies noted. This enabled the auditor to focus on the key areas and determine any actions taken by management to resolve the issues.

(Criteria: Pohnpei State Law 5L-08-00, Pohnpei State Financial Management Regulations and Fiscal Procedures Agreement, as applicable).

- a) The Department of Health Services is included in the Annual Single Audit of Pohnpei State Government which is being conducted by an Independent Auditor.
- Reviewed prior audits conducted by Independent Auditor and noted significant findings on the Department of Health Services, which is described on pages 14 – 16, as Finding No. 2017-03.
- b) The FSM Office of the National Public Auditor conducted and issued its Audit Report No. 2014-06, relating to the Department of Health Services procurement practices revealed the following weaknesses.
- Absence of Inventory Management System for \$3.8 million purchases;
 - Deliveries of approximately \$415 K paid medical and pharmaceutical supplies cannot be accounted;
 - Frequent use of emergency orders increased the cost of buying medicines;
 - Savings of approximately \$400 K could have been generated if biddings were done; and,
 - Quality assurance did not consistently ensure receipt of quality medicines.
- c) Pohnpei State Office of the Public Auditor conducted a performance audit of the procurement activities of the DHS for the FY 2008. The audit report identified and reported the following findings:
- DHS did not fully comply with the Pohnpei State Financial Management Regulations on procurement;
 - Pharmaceutical and medical supplies purchased were not properly accounted for; and,
 - Weak internal control in the issuances of pharmaceutical and medical supplies from the Central Medical Supply to the other sections of DHS.

A follow up review of the implementation of audit recommendations on January 11, 2013, revealed that the DHS had taken appropriate measures to resolve the findings noted.

5) Reviewed the Internal Control Structure

Control Environment:

The DHS is headed by a Director. There are four Divisions within the Department, each headed by a Division Chief. The procurement process starts with the preparation of a Purchase Requisition (PR) by the Administrative Officer of each Division subject to review and signature of the respective Division Chief as requestor. The PR is forwarded to the Department's Fiscal Officer for further review and fund sufficiency. The DHS Director is responsible for the Purchase Requisition final review and approval/disapproval.

After the Director's approval, the PR is submitted to the Finance Section of the Department of Treasury and Administration (DoT&A) for fund certification and expenditure compliance. A Purchase Order (PO) is prepared by the Procurement Officer within the DoT&A and the completed PO is then sent to the Department of Health Services to procure the goods itemized in the PO from the vendor.

Accounting System:

The Department of Treasury and Administration (DoT&A) is responsible for the processing of purchase orders, payment disbursement, recording and accounting of purchase transactions. The Department of Health Services is responsible for price quotations, preparing the purchase requests and ensuring that goods and services are properly delivered, utilized, managed and accounted for in the most efficient and economical manner.

Control Activities:

The contract cycle involves the preparation of the contract document initiated by the DHS for submission to DoT&A for review, fund certification and compliance, and processing of contract in accordance with the FMR requirements. Contract processing involves the following phases:

- Legal review which is done by the Office of Attorney General;
- Budget review which is done by the State Budget Officer;
- Fund certification and Compliance by DoT&A;
- Technical specification review as needed; and,
- Evaluation and approval phase.

- 5) Performed Risk Analysis;
- 6) Reviewed the Organizational Chart, Flow Chart of the Procurement Process;
- 7) Examined documentary evidence supporting the transactions recorded in the accounts;
- 8) Conducted interviews of key officials and personnel;
- 9) Examined records and conducted direct confirmation of procurement as necessary;

- 10) Reviewed laws, rules and regulations and policies and procedures applicable to procurement;
- 11) Reviewed annual procurement plan, budgets and projections;
- 12) Reviewed the adequacy of internal controls over procurement management; and
- 13) Performed other auditing procedures as applicable.

Conclusion:

1. Department of Health Services has not fully complied with the best practices in procurement regulations. There is a need to strengthen existing Pohnpei State financial management regulations to include guidelines on preparation of procurement plans and improve steps to initiate procurement which should be observed by the Departments. DHS needs to improve the existing procedures in initiating procurement activities in order to comply with the best practice.
- 2A. Department of Health Services has not fully complied with Pohnpei Financial Management Regulations (FMR) requiring that procured government assets needs to be properly receipted, tagged, utilized, maintained and accounted for.

DHS needs to prioritize the procuring of needed accessories for the X-ray machine purchased more than a year ago. The machine is sitting idle at DHS exposed to the possibility of loss to its value and benefit. There is also a need to update and improve the existing regulations to provide suitable policies and best practice on the procurement process and activities such as requiring the need assessment and pre-planning on procurement of fixed assets.
- 2B. The existing property accountability process has not fully complied with the Compact Fiscal Procedures Agreement Article VI, Sec. 1(J) in maintaining effective controls and accountability process.
3. The DHS procurement contracts did not fully comply with the requirement of the Pohnpei Financial Management Regulations Part 6.10 for open competitive bidding by sealed bids. Management's failure to publically advertise or announce to the general public by any means the need for vendors/contractors to bid on the specific projects heightens the risk of fraud, abuse and mismanagement of program funds.
4. The lack of documentation to support procurement transactions is non-compliance with procurement regulations.
- 5A. The inadequate maintenance of an effective inventory system does not fully comply with best practice of properly accounting for the procurement of medicines and pharmaceutical supplies.
- 5B. Management was not able to fully comply with the requirement of ensuring that procured assets are properly recorded in the inventory reports and reconciliation of property records between DHS and Supply Section was not also prepared. Management was not able to ensure the maintenance of all the fixed assets procured during the years examined and to properly account for all fixed assets procured.

DEPARTMENT OF HEALTH SERVICES
Compliance Audit on Procurement Practices
Schedule of Findings and Recommendations
Fiscal Years 2014 and 2015

2017-1: DHS did not follow procurement process that includes: a) procurement planning, b) procurement preparation and c) procurement implementation.

The Department of Health Services receives its operations and program funds on a quarterly basis. The Director of DHS is designated as the allottee of all DHS funds and is responsible for reviewing and approving all purchase transactions initiated by the department, regardless of the source and amount. The DHS procurement process is as follows:

1. The Divisions of the Dental Services and the Public Health are responsible to initiate their purchase requisitions (PR) for review and signature of the Division Chiefs as requesting officials. Signed PRs are forwarded to the Fiscal Officer of DHS for review of funds availability, budgetary and regulatory compliance, accuracy and completeness. Completed PRs are then submitted to the Director of DHS for final review, approval and transmittal to the Department of Treasury and Administration (DoT&A) for processing.
2. For the two other divisions, the Division of Administration and the Hospital Division, the DHS Fiscal Officer is responsible for the preparation of their Purchase Requisitions (PR) for the review and approval of the Director of Health Services. Similarly, completed PRs are submitted to the DoT&A for further processing.

Part 6.5 of the Financial Management Regulations (FMR) requires that all Pohnpei Government purchases with amounts less than \$25,000 shall include price quotations from at least three (3) vendors. Each initiating agency of the Pohnpei Government is responsible for the preparation of Purchase Requisition. Once prepared and approved by the appropriate allottee, the Requisition shall be submitted to the Director of DoT&A with the three or more performa invoices received from vendors. The Director of DoT&A shall review the Requisition for budgetary and procurement compliance, fund certification and issuance a Purchase Order for procurement of the supplies, personal property or services required.

In determining the applicability of, and compliance with open competitive bidding, the Director of DoT&A may accept no less than three price quotations from the purchasing government agencies for purchases of less than \$25,000. Purchases involving a cost of \$25,000 or more shall be carried out in accordance with the public bidding process requirement. The vendor with the most attractive and best quality offer is identified and a Purchase Order is prepared by DoT&A and forwarded to the purchasing government agency or vendor for the procurement and delivery of goods and services.

Criteria:

Part 6.15 of the Financial Management Regulations provides guidelines on the Invitation for bids, which shall be prepared and issued by the Director of DoT&A and shall include the following information:

- a) Name and address of the procuring agency;
- b) Date of issuance;
- c) Date, hour and place of opening of bids, if such bids are to be "Sealed Bids";
- d) Requisition of other purchase authority and any accounting data of information;
- e) Description of property or services to be furnished, in sufficient detail to permit full and free competition. For items requiring open bidding, the purchase description, as well as other forms of specifications, must accurately reflect the needs of the Government. Purchase descriptions used in competitive procurement shall not specify a product having features which are particular to the product of one manufacturer, producer or distributor, and thereby preclude consideration of a product of another company, unless it has been determined in writing by the user that those particular features are essential to the State's requirements, and that similar products of other companies lacking those features would not meet the minimum requirements for the product or service.
- f) The time, place and method of delivery;
- g) The bid number, if any;
- h) Permission if any to submit bids by electronic means such as cable, telex, fax, E-mail, or any other such means of electronic communication currently known or unknown;
- i) Requirements for bid guarantees or performance and payment bonds;
- j) Any provisions relating to property or services to be provided by the State;
- k) Where bidders are required to have special technical qualifications due to the complexity of the property or service being procured, or for some other such reason, a statement of such qualifications.
- l) Any authorized special provisions necessary for the particular procurement relating to such matters as progress payments, license requirements, liquidated damages, preference to local bidders, and the like;
- m) Directions for obtaining copies of any documents such as plans, drawings and specifications; and,
- n) That all bids, when submitted constitute a certification of price determination.

Best practice should be applied considering the US Federal Acquisition Regulations Part 67 as a guide for Acquisition/Procurement Planning. Best practice guidelines in the Federal Acquisition Regulations provide guides to the preparation of an acquisition plan. Various factors or elements are considered in the contract planning in order to determine what needs to be achieved and whether it is in the best interest of the government.

Condition:

Review of the Departments budget for FY 2014 and FY 2015 revealed that management did not prepare an Annual Procurement Plan. This was confirmed through interview of each of the Divisions key staff. The staffs acknowledged that they only prepared budgets

but not the annual procurement plans. The annual budget describes the funding requirements for the programs. However, specific procurement plans for each of the activities are not included in the budget.

The DHS Fiscal Officer informed the auditors that procurement activities are scheduled on a quarterly basis based on budget allocation. DHS does not have a procurement committee. Each Division takes care of its own purchase requisitions. There is lack of regular review of vendors and what products they provide mainly due to limited number of vendors. DHS selects the lowest cost in procuring the goods or services. Assessments on actual activities are not undertaken due to the absence of procurement plans. The DHS management's practice is to identify the big items to be procured and include these items in the budget.

Review of procurement contract revealed that there are no contract review done, no procurement implementation review and no record of the performance of suppliers in the past that were considered in the Procurement decisions of DHS.

DHS disseminate information or reports on its procurement activities to government leaders and to the Regional offices such as the Center for Disease Control and World Health Organization. However, it does not evaluate and benchmark its performance against purchases comparing practices and procedures, comparing prices and transaction costs, for example.

DHS is in charge of reviewing the vendor's performance. DHS is also in charge of the verification of actual procurement undertaken comparing it to procurement plans in order to determine whether plans or targets have been achieved to identify lessons learned. DHS is also in charge of procurement implementation review and what actions are taken to improve procurement activities. These however, were not performed by DHS.

Cause:

There were minimum guidelines on the preparation of procurement plans to make the Department of Health Services be aware of the steps in planning a procurement beginning with the initiation, identification of the needs and analysis of the project, then specifying the requirements and plan approach to market evaluation.

The existing Pohnpei State's regulation on procurement only have basic guidelines on procurement and has not addressed regulations on preparation of procurement plans that would be observed by the Departments.

Effect:

The basic guidelines on the preparation of procurement plans resulted to lack of awareness and guidance for the Department of Health Services staff to properly prepare for procurement activities particularly the needs assessment, specification requirements and plan approaches to procurement.

Conclusion:

The Department of Health Services has not fully complied with the best practices in procurement regulations.

There is a need to strengthen existing Pohnpei State financial management regulations to include guidelines on preparation of procurement plans and improve steps to initiate procurement which should be observed by the Departments.

DHS needs to improve the existing procedures in initiating procurement activities in order to comply with the best practice.

Recommendation:

We are recommending for the strengthening of the existing Financial Management Regulations and to prepare necessary guideline including regulations on procurement plans according to best practice which should be observed by the departments.

We are also recommending that DHS initiate the preparation and implementation of procurement plans identifying the procurement needs, properly consider proper approaches to procurement, preparation of procurement processes and implementation of procurement

2017 - 2A:Non-utilization of x-ray equipment purchased for immobile patients

During the fiscal years 2014 and 2015, a total of \$335,537 worth of fixed assets was purchased by DHS. This consists of 58 fixed assets items as follows:

- 3 vehicles
- 1 flat panel x ray machine
- 3 infant incubators
- 2 infant warmers
- 2 dental vacuum pumps
- 1 dental air compressor
- 1 rix compressor
- 8 lap top computers
- 1 standard radio HF
- 1 Operating System with Access
- 18 desk top computers
- 13 air conditioners
- 1 washing machine
- 1 PA system PYLE
- 2 jeep

One of the 58 items procured is a flat panel x ray digital machine costing \$39,000. Actual inspection and interview of DHS staffs revealed that the x ray machine was never used and has remained idle for more than 2 years. Our inquiry revealed that DHS needs to purchase additional equipment and accessories to be connected to the x ray machine before it can start to run.

Criteria:

Part 7.2 of the Pohnpei State Financial Management Regulations requires that procured government assets needs to be properly utilized for the intended purpose of procurement. In addition, "All employees of the Pohnpei Government are responsible to ensure that properties under the jurisdiction of the Pohnpei State Government are utilized and maintained."

Condition:

Walkthrough of the procurement process revealed that DHS management do not prepare a need assessment and pre-planning when procuring goods and services. Interview of the Fiscal Officer also confirmed that they don't have specific details when procuring fixed assets.

Cause:

There was lack of proper planning and needs assessment to ensure that goods or services are acquired in order to address the need. Management relied on budgets and procure goods and services when funds are available. They were unable to prepare the specific details of assets and services that need to be purchased and there was also lack of pre-planning on procurement.

Effect:

As a result of lack of planning and need assessment, a flat panel digital x-ray machine was procured but without the necessary accessories required to enable it to be operational.

Conclusion:

The Department of Health Services has not fully complied with Pohnpei Financial Management Regulations requiring that procured government assets needs to be properly utilized. DHS needs to prioritize the procuring of needed accessories to start using the x ray machine. There is also a need to improve existing regulations to consider requiring the need assessment and pre-planning on procurement of fixed assets.

Recommendation:

We are recommending management to conduct a need assessment identifying assets or services to be procured. For assets to be procured, management should identify assets specification requirements to properly procure the item needed. We also recommend strengthening existing regulations to include needs assessment and pre planning to be undertaken before procuring fixed assets.

2017-2B: Non-implementation of an effective asset and property accountability process in the department.

A meeting with management's key staffs to discuss about accountability and fixed assets recording and reporting of the various divisions in DHS was held. We found that there were

no written documentation or memorandum receipts to track location of fixed assets assigned for the use of employees.

Copies of the fixed assets listing was requested from each Division but were not readily available and management requested time to update the listing. The State Supply Division was able to provide the list of fixed assets procured during the two fiscal years. Our audit team was able to conduct inspection of the assets listed on the list and verified existence, location and condition of the assets.

Criteria:

The Fiscal Procedures Agreement- (Agreement Concerning Procedures for the Implementation of United States Economic Assistance Provided in the Compact of Free Association, as amended) between the government of the United States of America and the Government of the Federated States of Micronesia. Under the Compact, FSM agreed to "maintain effective controls and accountability for all Grant and Sub-grant cash, Real Property, personal property and other assets to safeguard and ensure uses are solely for authorized purposes."

Thus in order to maintain controls and accountability, management should ensure that assets procured are properly accounted for. Management should provide written acknowledgment of property assigned for the use of employees and that management should be able to keep track of fixed assets condition and location.

Condition:

DHS was not able to properly account for the fixed assets procured. Office visits and inspection conducted revealed the following:

It was noted that of the 58 fixed assets procured during the two fiscal years, there were two units of desk top computers of the Administration Division costing \$1,178.95 each with a total value of \$2,358 were missing during the time of the inspection in August 2016 and still could not be found during another visit in October 28, 2016. The missing computers have tag nos. PSG 14227 and PSG 14229. All the other 56 fixed assets were accounted for.

The Administrative Division failed to identify to whom the two missing computers were assigned. There was absence of memorandum receipt of fixed assets assigned to employees.

We also noted that the inventory of fixed assets purchased was not available during visits to the office and the DHS divisions.

Cause:

There was lack of accountability system that would address the preparation of written records and memorandum receipts of fixed assets. DHS has not designated staffs to prepare accountability records and reports.

Effect:

The absence of written records on fixed assets accountability and assignment to employees resulted to not being able to keep track, monitor and properly account for the fixed assets.

Conclusion:

The existing property accountability process has not fully complied with the Fiscal Procedures Agreement Article VI Sec. 1(J) in maintaining effective controls and accountability process.

Recommendation:

We are recommending management to rectify and improve the existing property accountability process by considering the preparation of written records and memorandum receipts of fixed assets assigned to employees to ensure that assets procured are properly safeguarded and properly accounted for.

2017-3: Awarding of procurement contracts to vendors without following the bidding regulations.

Procurement contracts costing \$25,000 and above should be carried out in accordance with the competitive bidding process. DHS Director is responsible for preparing the request for procuring of the goods and services needed and transmits the request to the Director of DoT&A for review and processing. DoT&A is responsible to review the request and issue the invitation for bid to the public in accordance with the procurement bidding guidelines as stipulated in the FMR.

Our review of the DHS procurement activities costing \$25,000 and above revealed that 3 of the 9 procurement conducted did not follow the bidding requirements.

Criteria:

Part 6.5 of the Financial Management Regulations provides guidelines on the purchasing procedure requiring the conduct of the public bidding process for procurement costing \$25,000 or more.

The Grant Terms and Conditions of the FY-2015 Compact Health Sector Carry over Funds also require that the grantee is responsible for complying with the provisions of all laws and regulations governing the use of the Federal grant funds. In addition, the following provisions need to be observed on procurement.

- a. Procurement of goods and services with grant funds: The grant award should not be considered an approval or endorsement of the procurement methods used by the grantee. Grantees must comply with all applicable laws and regulations governing the use of Federal grant funds when procuring goods and services under the grant. As this project may be selected for evaluation, please ensure that the documentation to support the history of the procurement is complete and available for review. Funding of this project may be subject to verification of compliance with applicable procurement requirements.

- b. Procurement Process Certification: Prior to the first drawdown of funds, the grantee must provide a written certification to the OIA grant manager that the applicable laws and regulations governing the use of Federal grant funds were complied with for the procurement of any goods and/or services under the grant.

Condition:

Of the 9 procurement contracts reviewed 3 contracts did not follow bidding regulations described as follows:

- a) Inventory System Contract costing \$57,813.75

1. Client licenses, tender module, web server	\$16,450
2. Consulting, travel, daily allowance	31,440
3. Hardware and printing supplies	5,270
4. Recurring yearly cost, support,	
Up to date program & annual subscription	4,653.75
Total	\$57,813.75

- b) Contract amounting to \$37,000 with the following job description:

- 1. After school sports program
 - a. Meeting with all stakeholders
 - b. Agree on what sport they will do
- 2. Increasing physical activity in the municipalities
- 3. Monthly music competition for PH topics

- c) Contract amounting to \$54,425 with the following job description:

- 1. Production of Immunization Education Awareness Materials
- 2. Printing of Immunization Materials
- 3. Painting of Immunization Mobile Clinic
- 4. Production of Family Planning Educational Awareness Materials
- 5. Printing of Family Planning Materials

There was lack of controls in ensuring that bidding regulations are observed. Interview response of Fiscal Officer on June 27, 2016 was, "We did not follow the bidding process because the vendors will provide services. We used the reprogram format. Our request was approved based on the identification of vendors".

In addition, management's justification letter dated June 23, 2016 indicated that the reason why there was no bidding is that the funds were already approved on the Inventory System. Another reason is that there is no other NGO or other organizations that has the capacity to meet the objectives for the after school program, increasing physical activity and monthly music competition.

Cause:

There was inadequate supervisory and oversight review and inadequate processing review of bidding documents prior to signing and approval signatures of the procurement contracts.

Effect:

The Pohnpei State Annual Financial Audit for FY 2015 conducted by the Independent Auditor, Deloitte & Touche included in the Schedule of Findings and Questioned Cost similar findings on procurement on providing full and open competition among vendors.

The contracts being questioned are:

1. After school sports program, increasing physical activity and monthly music competition.
2. Inventory System Contract.

The questioned cost represents 50% of the down payment which the Independent Auditor reported.

Conclusion:

The DHS procurement contracts did not fully comply with Pohnpei State Financial Management Regulations 6.10 for open competitive bidding by sealed bids requirement. Management's failure to advertise or announce to the public by any means the need for vendors/contractors to bid on the specific projects heightens the risk of fraud and mismanagement of program funds.

Recommendation:

Management should strictly comply with laws and regulations on procurement particularly the bidding regulations. In addition, management controls should be improved by implementing a control process in the Department of Health Services that would ensure documentation review and supervisory review.

Pohnpei State Government procurement process should implement a documentation review at all stages from the DHS Contracting Officer, Legal Review, Budget Certification, Fund Certification and Director of Treasury review. A checklist of the documentation required in processing the procurement together with the complete set of supporting documents should be attached to the contract prior to approval signatures and processing of payments.

2017 - 4: Procurement related disbursements made without supporting documentations.

DHS did not have proper records and file management system for its procurement functions. Procurement transactions must have the required documents before it gets processed and

paid. Our review of the procurement revealed that there were 17 procurement disbursements made without ensuring the adequacy of supporting documentation on procurement. Several attempts were made to request for supporting documents but new staffs were not able to locate some files and documents.

There was also lack of supervision on staffs to ensure that there is an organized filing system of documents and records.

Criteria:

Pohnpei Financial Management Regulations Section 1.9 requires that an obligation of the government is not valid unless it is supported by documentary evidence. In addition, the Compact Fiscal Procedures Agreement also requires that all financial and programmatic records, supporting documents and other records should be maintained and retained for at least three years.

Condition:

Our review of the procurement revealed that of the 141 procurement transactions selected for testing, 17 transactions were paid without supporting documentation.

There was also a procurement contract for the installation of 48 solar led lights costing \$68,160 that has a supporting document of a picture that is different from what should be accomplished. There was also absence of an Inspection Report necessary to support the disbursement and to justify that the project has been completed.

Cause:

There was inadequate review of documentation prior to processing payments and lack of supervisory review on the work done by staffs to ensure completeness of accounting records and files are kept according to regulations.

Effect:

Procurement contracts were processed without adequate supporting documentation.

Conclusion:

The lack of documentation on the procurement transactions is non-compliance with procurement regulations.

Recommendation:

Management should strictly observe review of documentation before processing payments and ensure that records and files are retained for a minimum period of at least three years for records and reporting purposes.

Supervision of staffs assigned to keep orderly and complete accounting records needs to be improved to strengthen controls and accountability.

2017-5 A: Non-maintenance of an inventory system for medicines and pharmaceutical supplies.

Visits to the Pharmacy Section and interviews conducted on key pharmacy staffs revealed that DHS still uses a manual inventory system for recording the receipts, issuances and balances of the medicines. A computerized inventory system was purchased in August 2015 but has not been updated to record the medicines and input the transactions affecting the inventory.

Criteria:

Best practice requires that there should be an efficient inventory system to properly account for the receipt, usage and balances of the medicines and pharmaceutical supplies.

In addition, adequate monitoring, review of the records and files maintained including the supervision of staffs are necessary to properly account for the procurement of medicines and pharmaceutical supplies.

Condition:

A walk through of the manual inventory system revealed the following:

1. Deliveries of medicines and pharmaceutical supplies procured are received and reviewed by the Pharmacy staffs and placed in a stock room.

Purchase orders files are maintained and procured items are recorded in stock cards. Monthly files of purchase orders and deliveries are maintained by the Pharmacist.
2. For the issuance of medicines and pharmaceutical supplies, an issuance forms must be prepared prior to issuing the items. Our review of the files showed that not all the issuance forms were prepared.
3. Of the 134 medicines listed in the inventory report valued at \$193,327, there were 3 items without price because the staffs were not able to keep track of the prices. Previous staff assigned to prepare inventory reports left without completing the reports and new staffs were not trained to continue the work.
4. Monthly summary reports of items received, issued and balances were not also prepared. There was absence of supervisory review and monthly summary reports were not demanded by management from the Pharmacy Section.
5. Pharmacy staffs that will be using the Computerized Inventory System still need training to access and update the new system.

Cause:

Management has not prioritized the training of the Pharmacy staffs to upgrade skills in the preparation of the inventory reports and computer training on the use of the newly acquired inventory system still has to be conducted.

Management has not also emphasized the monthly reporting requirements for procured medicines and pharmaceutical supplies summarizing inventory received, issued and balances.

Management has not strictly required the monitoring, review and supervision of staffs to ensure that procured items are properly accounted for.

Effect:

DHS was not able to fully account for the procured medicines and pharmaceutical supplies.

Conclusion:

The inadequate maintenance of an efficient inventory system does not fully comply with best practice of properly accounting for the procurement of medicines and pharmaceutical supplies.

Recommendation:

Management should ensure that an efficient inventory system be made operational and working. Training of Pharmacy staffs assigned to use the computerized inventory system should be prioritized.

Management should improve monthly reporting requirements for procured medicines and pharmaceutical supplies to properly account for the procured items.

Supervisory monitoring and review of work done by staff also needs to be improved.

2017-5B: Non-maintenance of inventory records of procured assets and no-reconciliation with State Supply and Property records.

Criteria:

The Compact Fiscal Procedures Agreement established the minimum requirements for managing equipment.

First, property records which include the property description, serial number (or other identification number), acquisition date and cost, percentage of US funding, location, condition, and other information, must be maintained.

Second, a physical inventory of the property and reconciliation with property records must

be performed at least every 2 years.

Management is also responsible to ensure the maintenance of fixed assets and to properly account for them.

Condition:

Our audit team visited all the Divisions of DHS and met with each of the Division Chiefs.

We found that the inventory listing has not been updated and no reconciliation of records between DHS and the State Supply Office was made. This happened because management depended on the Supply Section to prepare the annual inventory report first before updating their records.

We also found that the Division Chiefs are not properly informed of the responsibility of preparing the fixed assets inventory reports. Also, the staffs assigned to keep track of the fixed assets needs supervision and training on inventory report preparation.

Based on the inventory listing provided by the Supply Section, we noted the condition of the 58 fixed asset procured during the year.

- 16 items were not properly tagged
- 9 items were broken
- 43 items were in good working condition
- 2 items were missing

Management is responsible for the maintenance of all fixed assets procured and to ensure that fixed assets are properly accounted for.

There were also donated items that were observed during the inspection. However, the Divisions having custody of the donated items do not have records and documents about the donated assets.

Cause:

The regulations on the preparation of property records and physical inventory of property procured by DHS were not properly disseminated to all the Division Chiefs and key staffs responsible for preparation of the inventory reports. Key staffs responsible to prepare inventory reports should have been properly informed and trained to perform the work.

There was also lack of awareness as to the maintenance and proper accountability on fixed assets. Records of fixed assets acquired or obtained from donations should have been maintained and filed.

Effect:

Inventory records and reports were not updated to reflect all assets procured and acquired by DHS and reconciliation of property records was not prepared according to regulations.

Conclusion:

Management was not able to fully comply with the requirement of ensuring that procured assets are properly recorded in the inventory reports and reconciliation of property records between DHS and Supply Section was not also prepared.

Management was not able to ensure the maintenance of all the fixed assets procured during the year and to properly account for all fixed assets procured.

Recommendation:

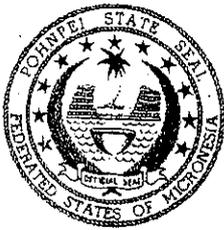
Management needs to inform all Division Chiefs and key staffs of the regulations on fixed assets accountability and inventory reporting responsibility. There is also a need to provide guidance and train staffs in charge of inventory record keeping and reporting.

Management should ensure that fixed assets inventory are updated by recording procurement on a monthly basis and reconcile the fixed assets inventory with State Supply and Property Records at least every two years to comply with the regulations.

**Compliance Audit of Procurement Practices
Of Department of Health Services**

Exhibit I – Auditee Response

Fiscal Years 2014 and 2015



Office of the Director

2/11/17 Rca
OPA
ape

Exhibit I
Department of Health Services
Pohnpei State Government

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May 11, 2017

The Honorable Ihlen Joseph
Administrator
Office of the State Public Auditor
Pohnpei State Government
Kolonia, Pohnpei 96941

Dear Administrator Joseph,

In response to your letter dated March 08, 2017 concerning specific audit issues that have arisen from observations focusing on recent procurement practices, the Department of Health Services has opted to put in place the following internal controls to alleviate future discrepancies.

1. Concerning bids that are larger than \$25K

a. DHS has implemented a new purchase request system that will monitor and log when a bid is required.

2. Monitoring and tracking purchase requests

a. DHS has implemented an internal tracking system

i. Places an internal tracking number to monitor the processing status of each purchase request.

ii. Monitor efficiency of processing from the dates received and the date delivered to State Finance Team.

3. Backup and supporting documentation

a. All purchase requests will include an internal checklist that will require the following minimum items with the completed purchase request form:

i. 3 valid quotations for bids < \$25K

ii. Budget verification – current Finance Report #132P

Exhibit I

- iii. Copy of Program Narrative to show scope of purchase
 - iv. Verified approvals from appropriate Chiefs and then Director acknowledgement.
4. Centralized Purchase Request Processing
- a. DHS has now centralized its purchase request processing system.
 - b. This system is located in the main administrative building and has a 3 dedicated staff to process all incoming requests, monitor status of each request and also validate when the Purchase Order has received and then logged to the appropriate division for their records.

All the above procedures have been designed address the discrepancies in processing of all purchase requests but also to monitor that all required Procurement requirements are addressed and processed in a controlled and transparent manner.

Training of the above new procedures have already started and will be completed this Friday with the last of the Program Managers being trained on the new procedures.

Sincerely,


Kapilly Copelle
Director